

ANNUAL REPORT

2019

To Our Stockholders:

Net income for the year ended December 31, 2019 was \$2.4 million, \$421 thousand less than the same period in 2018. On a per share basis, net income was \$.72 this year versus \$.84 last year.

Lower net income this year is attributable to higher expenses, specifically the provision for loan losses, prepayment penalties on FHLB advances, employee benefits and data processing. These increases were partially offset by gains on the sale of securities, higher net interest income and lower income tax expense.

After a very promising start to the year, it became apparent, in early October, that MCT would not achieve the 2019 financial goals we established for the corporation. Moreover, the outlook for interest rates was changing and higher credit losses from our purchased consumer loan portfolio were expected.

Faced with this situation, management undertook a series of strategic initiatives intended to improve profitability by increasing net interest income and normalizing future contributions to the loan loss provision. Because the implementation of these initiatives had a significant impact on 2019 growth and earnings, this year's financial statements are best explained within the context of these actions.

During Q4 2019, management took advantage of a volatile interest rate environment to deleverage the balance sheet, restructure the investment portfolio and reduce long-term debt, using gains from the sale of securities to offset pre-payment penalties on long-term debt. The net results from these transactions was a reduction in interest expense and an increase in net interest margin.

To provide for projected losses in the purchased consumer loan portfolio, a portion of the gains from securities sales were used to fund an increase in the provision for loan losses. This year, the additional contribution to the allowance for loan losses was made with the expectation that future provision expense will be more in line with historical averages.

On December 31, 2019, securities available-for-sale totaled \$189.3 million, versus \$188 million last year. The modest year-over-year change in the size of the portfolio is directly attributable to the balance sheet deleveraging described above and the composition of the portfolio, which has been modified to better position the bank for lower interest rates.

Net loans receivable totaled \$220 million at year end 2019, virtually unchanged from last year. Lower loan growth this year is attributable to early payoffs from purchased commercial participation loans and the rapid pay down of the purchased consumer loan portfolio. MCT stopped purchasing consumer loans in the second half of the year and is allowing the portfolio to run off because our loss experience was higher than expected. Replacing this volume may take time but this decision should have a positive impact on asset quality.

Total deposits were \$361.7 million for December 31, 2019 or an increase of \$31.1 million over last year. Strong growth in both core and time deposits, in tandem with our deleveraging strategy, allowed the bank to reduce its use of other borrowed funds and long-term debt by \$35.7 million compared to prior year. Particularly noteworthy is the \$51 million reduction in high-cost, long-term debt from \$65 million in December of 2018 to \$14 million this year.

Total shareholder's equity, on December 31, 2019 was \$40.7 million, \$4.8 million higher than 2018. The change in equity capital this year is attributable to an increase in common stock associated with the 10% stock dividend paid in December of this year and a decrease in accumulated other comprehensive loss, partially offset by a decrease in retained earnings. MCTFC's equity capital remains well above the minimum regulatory requirements to be considered "well-capitalized."

Although 2019 financial results were disappointing, we successfully completed several major projects during the year to satisfy our customers' continuously evolving expectations and improve our competitive capabilities. These projects included:

- The March upgrade of our consumer and commercial online banking platform, which streamlined the enrollment process and access to convenience services like eStatements, bill pay, account/security alerts and internal/external transfers.
- The June introduction of our Business Remote Deposit service to enable commercial customers to deposit checks in bulk from the convenience of their office, using MCT-supplied scanning equipment.
- The July launch of our highly-rated, Mauch Chunk Trust mobile app featuring fingerprint/Face ID login, improved mobile check deposit and push notification alerts.

These enhancements have been well received by our customers and we are confident these new offerings, combined with the financial initiatives described above, have MCTFC positioned for a more successful 2020.

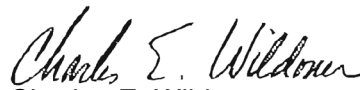
In January 2020, MCT lost a great friend and advocate with the passing of director James E. Smith Jr. Jimmy served, with distinction, as a member of our Board of Directors since 2000. He was proud to be associated with our bank and was always lavish with his praise of our staff, the quality of the service they provide our customers and their dedication to our organization. Likewise, Jimmy never missed an opportunity to encourage his many friends and acquaintances to consider MCT for all their banking needs. He was truly one of a kind and his presence will be greatly missed.

As always, we thank you for your continued loyalty and support.

Sincerely,



Patrick H. Reilly
President/Chief Executive Officer



Charles E. Wildoner
Chairman of the Board

	<u>Page</u>
Independent Auditors' Report	4
Consolidated Financial Statements	
Consolidated Balance Sheets	5
Consolidated Statements of Income	6
Consolidated Statements of Comprehensive Income (Loss)	7
Consolidated Statements of Stockholders' Equity	8
Consolidated Statements of Cash Flows	9
Notes to Consolidated Financial Statements	10

Independent Auditors' Report

To the Board of Directors of
Mauch Chunk Trust Financial Corp.

We have audited the accompanying consolidated financial statements of Mauch Chunk Trust Financial Corp. and its subsidiary, Mauch Chunk Trust Company, which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of income, comprehensive income (loss), stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mauch Chunk Trust Financial Corp. and its subsidiary as of December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Allentown, Pennsylvania
March 2, 2020

	2019	2018
Assets		
Cash and due from banks	\$ 6,120	\$ 5,152
Securities available-for-sale	189,320	188,071
Equity securities	153	223
Restricted investment in bank stocks	1,967	3,286
Loans receivable, net of allowance for loan losses		
2019 \$2,650; 2018 \$2,258	220,038	219,819
Bank premises and equipment, net	9,730	8,790
Accrued interest receivable	1,122	1,226
Investment in life insurance	9,694	9,416
Prepaid expenses and other assets	1,924	2,359
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Total assets	<u>\$ 440,068</u>	<u>\$ 438,342</u>
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Noninterest bearing	\$ 43,964	\$ 42,747
Interest bearing	317,745	286,831
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Total deposits	361,709	329,578
Securities sold under agreements to repurchase	3,173	3,440
Other borrowed funds	17,642	2,886
Accrued interest payable	94	168
Other liabilities	2,733	1,933
Long-term debt	14,010	64,460
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Total liabilities	399,361	402,465
Stockholders' Equity		
Common stock, no par value; authorized 15,000,000 shares;		
2019 issued 3,392,336 shares; outstanding 3,357,218 shares;		
2018 issued 3,087,228 shares, outstanding 3,056,843 shares	8,497	4,337
Retained earnings	33,263	36,195
Accumulated other comprehensive loss	(610)	(4,222)
Treasury stock, at cost 2019 35,118 shares;		
2018 34,436 shares	(443)	(433)
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Total stockholders' equity	40,707	35,877
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Total liabilities and stockholders' equity	<u>\$ 440,068</u>	<u>\$ 438,342</u>

Consolidated Statements of Income

Years Ended December 31, 2019 and 2018
(Dollars in Thousands, Except Per Share Data)

	2019	2018
Interest Income		
Loans receivable, including fees	\$ 10,883	\$ 9,249
Securities:		
Taxable	5,520	5,550
Tax exempt	200	210
Other	173	75
Total interest income	16,776	15,084
Interest Expense		
Deposits	3,143	2,153
Borrowings	1,587	1,261
Total interest expense	4,730	3,414
Net interest income	12,046	11,670
Provision for Loan Losses	1,240	343
Net interest income after provision for loan losses	10,806	11,327
Other Income		
Service fees	1,594	1,541
Wealth management fees	791	762
Net realized gains on sales of securities	1,369	221
Net realized gains on sales of foreclosed assets	10	98
Income on life insurance policies	251	253
Mortgage banking activities	26	-
Other	173	191
Total other income	4,214	3,066
Other Expenses		
Salaries and wages	4,173	4,021
Employee benefits	1,661	1,429
Occupancy and equipment	1,819	1,814
Director's fees	327	316
Professional fees	407	530
FDIC insurance and assessments	34	140
Foreclosed assets	12	34
Data processing	1,121	900
Advertising	202	192
Pennsylvania bank shares tax	217	240
Loss from extinguishment of debt	738	-
Other	1,444	1,434
Total other expenses	12,155	11,050
Income before income taxes	2,865	3,343
Income Tax Expense	460	517
Net income	\$ 2,405	\$ 2,826
Basic Earnings Per Share	\$ 0.72	\$ 0.84
Weighted Average Shares Outstanding	3,357,850	3,360,435

See notes to Consolidated Financial Statements

Consolidated Statements of Comprehensive Income (Loss)

Years Ended December 31, 2019 and 2018
(Dollars in Thousands)

	2019	2018
Net Income	\$ 2,405	\$ 2,826
Other Comprehensive Income (Loss)		
Unrealized holding gains (losses) on securities available-for-sale	5,957	(4,231)
Reclassification adjustment for gains on sales of securities available-for-sale realized in net income ^(a)	(1,369)	(221)
Net unrealized gains (losses)	4,588	(4,452)
Tax effect ^(b)	(963)	936
Net of tax amount, available-for-sale securities	3,625	(3,516)
Derivative adjustments	(17)	-
Tax effect ^(c)	4	-
Net of tax amount, derivative adjustments	(13)	-
Total other comprehensive income (loss)	3,612	(3,516)
Total comprehensive income (loss)	<u>\$ 6,017</u>	<u>\$ (690)</u>

^(a) Amounts are included in net realized gains on sales of securities on the Consolidated Statements of Income as a separate element within Other Income.

^(b) The tax effect on unrealized holding (losses) gains on securities available-for-sale was (\$1,250) and \$890 for the years ended December 31, 2019 and 2018, respectively. The tax effect on gains on sales of securities available-for-sale was \$287 and \$46 for the years ended December 31, 2019 and 2018, respectively. Income tax amounts on unrealized holding losses on securities available-for-sale are included in the net deferred tax asset as described in Note 12. Income tax amounts on gains on sales of securities are included in income tax expense on the Consolidated Statement of Income.

^(c) Income tax amounts on derivative adjustments are included in the net deferred tax asset as described in Note 12.

Consolidated Statements of Stockholders' Equity

Years Ended December 31, 2019 and 2018
(Dollars in Thousands, Except Share Data)

	Common Stock	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
Balance, December 31, 2017	\$ 4,337	\$ 34,667	\$ (660)	\$ (373)	\$ 37,971
Net income	-	2,826	-	-	2,826
Other comprehensive loss	-	-	(3,516)	-	(3,516)
Dividends on common stock (\$0.40 per share)	-	(1,344)	-	-	(1,344)
Acquisition of treasury stock	-	-	-	(60)	(60)
Reclassification of unrealized gains on available-for sale equity securities due to adoption of ASU 2016-01 (See Note 1)	-	46	(46)	-	-
Balance, December 31, 2018	4,337	36,195	(4,222)	(433)	35,877
Net income	-	2,405	-	-	2,405
Other comprehensive gain	-	-	3,612	-	3,612
Dividends on common stock (\$0.35 per share)	-	(1,175)	-	-	(1,175)
Stock dividends	4,160	(4,162)	-	-	(2)
Acquisition of treasury stock	-	-	-	(10)	(10)
Balance, December 31, 2019	<u>\$ 8,497</u>	<u>\$ 33,263</u>	<u>\$ (610)</u>	<u>\$ (443)</u>	<u>\$ 40,707</u>

See notes to Consolidated Financial Statements

Consolidated Statements of Cash Flows

Years Ended December 31, 2019 and 2018
(Dollars in Thousands)

	2019	2018
Cash Flows From Operating Activities		
Net income	\$ 2,405	\$ 2,826
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,240	343
Provision for depreciation	625	583
Amortization of purchased mortgage premium	85	85
Amortization of right of use asset	122	-
Net realized gains on sales of securities	(1,369)	(221)
Net unrealized loss on equity securities	30	27
Net gains on sales of foreclosed assets	(10)	(94)
Net (gain) loss on sale of bank premises and equipment	(25)	20
Net amortization (accretion) of securities premiums and discounts	67	32
Net decrease in lease liability	(122)	-
Deferred income taxes	44	(101)
Earnings on investment in life insurance	(251)	(253)
(Increase) decrease in assets:		
Accrued interest receivable	104	82
Prepaid expenses and other assets	(466)	(128)
Increase (decrease) in liabilities:		
Accrued interest payable	(74)	47
Other liabilities	71	278
Net cash provided by operating activities	2,476	3,526
Cash Flows From Investing Activities		
Available-for-sale securities:		
Purchases	(192,473)	(27,953)
Proceeds from sales	176,934	22,832
Maturities and principal repayments	20,239	5,953
Net maturities of interest bearing time deposits	-	1,016
Net increase in loans	(1,706)	(22,171)
Net decrease (increase) in restricted investment in bank stocks	1,319	(1,013)
Purchases of bank premises and equipment	(856)	(393)
Purchases of life insurance	(27)	(23)
Proceeds from sale of bank premises and equipment	42	-
Proceeds from sale of foreclosed assets	37	251
Net provided by (cash used) in investing activities	3,509	(21,501)
Cash Flows From Financing Activities		
Increase in deposits, net	32,131	22
Decrease (increase) in securities sold under agreements to repurchase	(267)	403
Net borrowings (repayments) of other borrowed funds	14,756	(4,097)
Proceeds from long-term debt	10,000	33,660
Repayment of long-term debt	(60,450)	(10,000)
Acquisition of treasury stock	(10)	(60)
Cash dividends	(1,177)	(1,344)
Net cash (used in) provided by financing activities	(5,017)	18,584
Net increase in cash and cash equivalents	968	609
Cash and Cash Equivalents, Beginning of Year	5,152	4,543
Cash and Cash Equivalents, Ending of Year	\$ 6,120	\$ 5,152
Supplementary Cash Flows Information		
Interest paid	\$ 4,804	\$ 3,367
Income taxes paid	\$ 505	\$ 555
Supplementary Schedule of Noncash Investing Activities		
Foreclosed assets acquired in settlement of loans	\$ 50	\$ 137
Recognition of operating lease right of use assets	\$ 848	\$ -
Recognition of operating lease liabilities	\$ 848	\$ -

See notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

Nature of Operations and Principles of Consolidation

The consolidated financial statements include the accounts of Mauch Chunk Trust Financial Corp., a bank holding company, and its subsidiary, Mauch Chunk Trust Company (collectively, the Company). All intercompany accounts and transactions have been eliminated in consolidation.

Mauch Chunk Trust Company (the Bank) operates under a state bank charter and provides full banking services, including trust services. As a state bank, the Bank is subject to regulation of the Pennsylvania Department of Banking and Securities and the Federal Deposit Insurance Corporation. The area served by the Bank is principally Carbon County, Pennsylvania. Mauch Chunk Trust Financial Corp. is subject to regulation by the Federal Reserve Bank.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of derivative financial instruments, the determination of other-than-temporary impairment on securities and the valuation of deferred tax assets.

Significant Concentrations of Credit Risk

Most of the Company's activities are with customers located within Carbon County, Pennsylvania. Note 3 discusses the types of securities that the Company invests in. Note 4 discusses the types of lending that the Company engages in. The Company does not have any significant concentrations in any one industry or customer. Although the Company has a diversified loan portfolio, its debtors' ability to honor their contracts is influenced by the regions' economy.

Cash and Cash Equivalents

For reporting of cash flows, cash and cash equivalents include cash on hand, amount due from banks and federal funds sold, all with maturities within ninety days. The Company maintains cash deposits in other depository institutions that occasionally exceed the amount of deposit insurance available. Management periodically assesses the financial condition of these institutions and believes that the risk of any possible credit loss is minimal. Generally, federal funds are purchased and sold for one day periods. There were no outstanding federal funds sold at December 31, 2019 and 2018.

Trust Assets

The Company provides trust services, including administration of trust and estates through its trust department. Assets held by the trust department in a fiduciary or agency capacity for its customers are not included in these consolidated financial statements because they are not assets of the Company. Trust income is recorded on a cash basis, which is not materially different from the accrual basis.

Securities

Securities classified as available-for-sale are those securities that the Company intends to hold for an indefinite period of time but not necessarily to maturity. Any decision to sell a security classified as available-for-sale would be based on various factors, including significant movement in interest rates, changes in maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations and other similar factors. Securities available-for-sale are carried at fair value.

Unrealized gains or losses are reported as increases or decreases, net of the related deferred tax effect, in other comprehensive income (loss). Equity securities are carried at fair value with changes in fair value reported in income. Realized gains or losses, determined on the basis of the cost of the specific securities sold, are included in earnings. Premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

Declines in the fair value of securities below their cost that are deemed to be other than temporary impairments (OTTI) are reflected in earnings as realized losses. In estimating OTTI for debt and equity securities, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than amortized cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions and (4) whether the Company has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. In instances when a determination is made that an other-than-temporary impairment exists but the Company does not intend to sell the debt security and it is not more likely than not that it will be required to sell the debt security prior to anticipated recovery, the other-than-temporary impairment is separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income.

The Company has not recognized any other-than-temporary impairment losses for the years ended December 31, 2019 and 2018.

Restricted Investment in Bank Stocks

Restricted investment in bank stock consists of Federal Home Loan Bank (FHLB) stock in the amount of \$1,892,000 and \$3,211,000 at December 31, 2019 and 2018, respectively, and Atlantic Community Bankers Bank stock in the amount of \$75,000 at December 31, 2019 and 2018. Federal law requires a member institution of the FHLB to hold stock of its district FHLB according to a predetermined formula. The restricted stocks are carried at cost.

Management's determination of whether these investments are impaired is based on the Company's assessment of the ultimate recoverability of the Company's cost rather than by recognizing temporary declines in value. Management believes no impairment charge is necessary related to these restricted stocks as of December 31, 2019.

Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by aggregate outstanding commitments from investors or current investor yield requirements. Net unrealized losses are recognized through a valuation allowance by charges to income. The Company had no loans held for sale at December 31, 2019 and 2018.

Loans Receivable

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances, net of an allowance for loan losses and any deferred fees or costs. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the yield (interest income) of the related loans. The Company is generally amortizing these amounts over the contractual life of the loan. Premiums and discounts on purchased loans are amortized as adjustments to interest income using the effective yield method.

The loans receivable portfolio is segmented into commercial and consumer loans. Commercial loans consist of the following classes: commercial and commercial real estate. Consumer loans consist of the following classes: residential real estate, home equity and other consumer.

For all classes of loans receivable, the accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Interest received on nonaccrual loans, including impaired loans, generally is either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally six months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The past due status of all classes of loans receivable is determined based on contractual due dates for loan payments.

Loans receivable includes a portfolio of purchased mortgages. Premiums related to this portfolio are amortized over the average expected term of the loans within the portfolio.

Allowance for Loan Losses

The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The allowance for loan losses is increased by the provision for loan losses and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan losses and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Because all identified losses are immediately charged off, no portion of the allowance for loan losses is restricted to any individual loan or groups of loans and the entire allowance is available to absorb any and all loan losses.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

The allowance for loan losses consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers pools of loans by loan class including commercial loans not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate, home equity and other consumer loans. These pools of loans are evaluated for loss exposure based upon historical loss rates for each of these categories of loans, adjusted for qualitative factors. These qualitative risk factors include:

1. Lending policies and procedures, including underwriting standards and collection, charge-off and recovery practices.
2. National, regional and local economic and business conditions as well as the condition of various market segments, including the value of underlying collateral for collateral dependent loans.
3. Nature and volume of the portfolio and terms of loans.
4. Volume and severity of past due, classified and nonaccrual loans as well as other loan modifications.
5. Existence and effect of any concentrations of credit and changes in the level of such concentrations.
6. Effect of external factors, such as competition and legal and regulatory requirements.

A majority of the Company's loan assets are loans to business owners of many types. The Company makes commercial loans for real estate development and other business purposes required by the customer base.

The Company's credit policies determine advance rates against the different forms of collateral that can be pledged against commercial loans. Typically, the majority of loans will be limited to a percentage of their underlying collateral values such as real estate values, equipment, eligible accounts receivable and inventory. Individual loan advance rates may be higher or lower depending upon the financial strength of the borrower and/or term of the loan. The assets financed through commercial loans are used within the business for its ongoing operation. Repayment of these kinds of loans generally comes from the cash flow of the business or the ongoing conversions of assets. Commercial real estate loans include long-term loans financing commercial properties. Repayment of this kind of loan is dependent upon either the ongoing cash flow of the borrowing entity or the resale of or lease of the subject property. Commercial real estate loans typically require a loan to value ratio of not greater than 80 percent and vary in terms.

Residential mortgages and home equity loans are secured by the borrower's residential real estate in either a first or second lien position. Residential mortgages and home equity loans have varying loan rates depending on the financial condition of the borrower and the loan to value ratio. Residential mortgages have amortizations up to 30 years and home equity loans have maturities up to 15 years.

Other consumer loans include installment loans, car loans and overdraft lines of credit. The majority of these loans are unsecured.

An unallocated component of the allowance is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and industrial loans, commercial real estate loans and commercial construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent.

An allowance for loan losses is established for an impaired loan if its carrying value exceeds its estimated fair value. The estimated fair values of substantially all of the Company's impaired loans are measured based on the estimated fair value of the loan's collateral.

For commercial loans secured by real estate, estimated fair values are determined primarily through third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal and the condition of the property. Appraised values are discounted to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

For commercial and industrial loans secured by nonreal estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's consolidated financial statements, inventory reports, accounts receivable agings or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

Loans whose terms are modified are classified as troubled debt restructurings if the Company grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate or an extension of a loan's stated maturity date. Nonaccrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive months after modification. Loans classified as troubled debt restructurings are designated as impaired.

The allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments, for commercial and consumer loans. Credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful and loss. Loans criticized as special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses. Loans not classified are rated pass.

In addition, Federal regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for loan losses is adequate.

Transfers of Financial Assets

Transfers of financial assets, including loan and loan participation sales, are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the related assets. Buildings are depreciated using useful lives ranging from 10 to 40 years. Furniture, fixtures and equipment are being depreciated using useful lives ranging from 3 to 10 years. Leasehold improvements are depreciated over the shorter of the useful life or lease term of the asset.

Investment in Life Insurance

The Company invests in bank-owned life insurance (BOLI) as a source of funding for employee benefit expenses. BOLI involves the purchasing of life insurance by the Company on a chosen group of employees and directors. The Company is the owner and beneficiary of the policies. This life insurance investment is carried at the cash surrender value of the underlying policies. These policies can be liquidated, if necessary, with tax costs. However, the Company intends to hold the policies and, accordingly, the Company has not provided for deferred income taxes on the earnings from the increase in the cash surrender value.

Foreclosed Assets

Foreclosed assets, which are included in prepaid expenses and other assets, are comprised of property acquired through a foreclosure proceeding or acceptance of a deed-in-lieu of foreclosure and loans classified as in-substance foreclosures. A loan is classified as in-substance foreclosure when the Company has taken possession of the collateral regardless of whether formal foreclosure proceedings take place. Foreclosed assets initially are recorded at fair value, net of estimated selling costs, at the date of foreclosure, establishing a new cost basis. After foreclosure, valuations are periodically performed by management and the assets are carried at the lower of cost or fair value minus estimated costs to sell. Gains and losses on sales of foreclosed assets, are part of other income in the accompanying consolidated statements of income. Revenues and expenses from operations and changes in the valuation allowance are included in foreclosed assets expenses in the accompanying consolidated statements of income.

Advertising

The Company follows the policy of charging the costs of advertising to expense as incurred. Advertising expense for the years ended December 31, 2019 and 2018 was \$202,000 and \$192,000, respectively.

Income Taxes

Income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. Deferred income taxes are provided on the liability method whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. Mauch Chunk Trust Financial Corp. and its subsidiary file a consolidated federal income tax return.

Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit and letters of credit. Such financial instruments are recorded in the balance sheet when they are funded.

Earnings Per Share

The Company has a simple capital structure. Basic earnings per share represent income available to common stockholders divided by the weighted average number of shares outstanding during the period.

Treasury Stock

Common stock shares repurchased are recorded as treasury stock at cost.

Recent Accounting Pronouncements, Adopted

The Company adopted Accounting Standards Update (ASU) No. 2016-02, *Leases (Topic 842)* on January 1, 2019, as described in Note 14, Right of Use Asset and Lease Liabilities. Other than the adoption of Topic 842 the significant accounting policies of the Company are substantially the same as those for the year ended December 31, 2018.

Newly Issued Not Yet Effective Accounting Standard

In June 2016, the Financial Accounting Standards Board (FASB) issued ASU No. 2016-13, *Financial Instruments - Credit Losses (Topic 326)* to replace the incurred loss model, which is referred to as the current expected credit loss (CECL) model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loans receivable and held-to-maturity debt securities. It also applies to off-balance sheet credit exposures including loan commitments, standby letters of credit, financial guarantees and other similar instruments. For the assets within the scope of CECL, a cumulative-effect adjustment will be recognized in retained earnings as of the beginning of the first reporting period in which the guidance is effective. This new standard will be effective for the Company in 2023. The Company is currently evaluating the impact this new standard will have on the consolidated financial statements.

Subsequent Events

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of December 31, 2019 for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through March 2, 2020, the date these consolidated financial statements were available to be issued.

2. Revenue Recognition

The Company generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed; charged either on a periodic basis or based on activity. Because performance obligations are satisfied as services are rendered and the transaction prices are fixed, there is little judgment involved in applying Topic 606 that significantly affects the determination of the amount and timing of revenue from contracts with customers. The main types of revenue contracts included in noninterest income within the consolidated statements of income are as follows:

Deposits Related Fees and Service Charges

Service charges and fees on deposits which are included as liabilities in the consolidated balance sheets consist of transaction-based fees, account maintenance fees and overdraft services fees for various retail and business checking customers. Transaction-based fees, which includes services such as automated teller machines (ATM) fees, Automated Clearing House (ACH) fees, stop payment charges and statement rendering fees are recognized at the time transaction is executed as that is the point in time the Company fulfills the customer's request. All deposit liabilities are considered to have one-day terms and therefore related fees are recognized as noninterest income at the time when the services are provided to the customer. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn directly from the customer's account balance.

Interchange Income

The Company earns interchange fees from credit/debit cardholder transactions conducted through the MasterCard payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized monthly, concurrently with the transaction processing services provided to the cardholder.

Gain/Losses on Sale of Foreclosed Assets

The Company records a gain or loss from the sale of foreclosed assets when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Company finances the sale of the foreclosed asset to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the foreclosed assets are derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on the sale, the Company adjusts the transaction prices and related gain (loss) on sale if a significant financing component is present.

Wealth/Asset/Trust Management Fees

The Company provides wealth management and trust services to individuals, corporations and retirement funds, as well as existing loan/deposit customers of the Company, located primarily within our geographic markets. The wealth management operations are conducted through Mauch Chunk Trust Company, the subsidiary of the Company and provides a broad range of personal and corporate fiduciary services, including the administration of decedent and trust estates. Assets held in a fiduciary capacity by Mauch Chunk Trust Company, are not assets of the Company and are therefore not included in the Company's consolidated financial statements. Wealth management and trust fees earned are included within noninterest income in the consolidated statements of income.

Wealth management fees are contractually agreed with each customer and earned over time as the Company provides the contracted monthly or quarterly services. Fees are generally based on a tiered scale based on average market value of the trust assets under management (AUM) at month-end. The services provided under such a contract are considered a single performance obligation because it embodies series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer. Fees that are transaction based, including trade execution services, are recognized at the point in time that the transaction is executed (i.e. trade date).

3. Securities

The amortized cost and approximate fair value of investment securities available-for-sale and equity securities as of December 31, 2019 and 2018 are summarized as follows:

	2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
State and political subdivisions	\$ 48,431	\$ 303	\$ (559)	\$ 48,175
Mortgage-backed securities, U.S. government sponsored enterprises (GSE's), residential	107,793	36	(731)	107,098
Corporate debt securities	33,852	246	(51)	34,047
Equity securities	153	-	-	153
	<u>\$ 190,229</u>	<u>\$ 585</u>	<u>\$ (1,341)</u>	<u>\$ 189,473</u>
	2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
State and political subdivisions	\$ 15,962	\$ 22	\$ (515)	\$ 15,469
Mortgage-backed securities, U.S. government sponsored enterprises (GSE's), residential	133,020	43	(4,144)	128,919
Corporate debt securities	44,406	44	(767)	43,683
Equity securities	193	30	-	223
	<u>\$ 193,581</u>	<u>\$ 139</u>	<u>\$ (5,426)</u>	<u>\$ 188,294</u>

The amortized cost and fair value of debt securities available-for-sale as of December 31, 2019, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because the securities may be called or prepaid with or without any penalties.

	Available-for-Sale	
	Amortized Cost	Fair Value
	(In Thousands)	
Due in one year or less	\$ 6,002	\$ 6,007
Due after one year through five years	14,417	14,420
Due after five years through ten years	17,594	17,908
Due after ten years	44,269	43,887
	82,282	82,222
Mortgage-backed securities	107,793	107,098
	<u>\$ 190,075</u>	<u>\$ 189,320</u>

Gross gains of \$1,461,000 and gross losses of \$92,000 were realized on sales of securities in 2019. Gross gains of \$352,000 and gross losses of \$131,000 were realized on sales of securities in 2018.

Securities with a carrying value of \$70,303,000 and \$63,915,000 at December 31, 2019 and 2018, respectively, were pledged to secure public deposits and for other purposes required or permitted by law. Securities with a carrying value of \$39,370,000 and \$42,309,000 at December 31, 2019 and 2018, respectively, were pledged to the Federal Home Loan Bank under its collateral requirements for advances made to the Company.

The following tables show our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2019 and 2018:

	2019					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
Securities available-for-sale:						
State and political subdivisions	\$ 36,179	\$ (537)	\$ 653	\$ (22)	\$ 36,832	\$ (559)
Mortgage-backed securities, GSE's	94,470	(731)	-	-	94,470	(731)
Corporate debt securities	5,064	(30)	5,041	(21)	10,105	(51)
	<u>\$ 135,713</u>	<u>\$ (1,298)</u>	<u>\$ 5,694</u>	<u>\$ (43)</u>	<u>\$ 141,407</u>	<u>\$ (1,341)</u>

		2018					
		Less than 12 Months		12 Months or More		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
		(In Thousands)					
Securities available-for-sale:							
State and political subdivisions	\$	11,125	\$ (320)	\$ 2,252	\$ (195)	\$ 13,377	\$ (515)
Mortgage-backed securities, GSE's		9,916	(32)	114,512	(4,112)	124,428	(4,144)
Corporate debt securities		28,968	(709)	3,121	(58)	32,089	(767)
	\$	50,009	\$ (1,061)	\$ 119,885	\$ (4,365)	\$ 169,894	\$ (5,426)

The Company has 61 and 72 securities in an unrealized loss position at December 31, 2019 and 2018, respectively. The unrealized losses at December 31, 2019 and 2018 are due to interest rate fluctuations. None of the securities are below investment grade. None of the individual losses above are deemed significant. None of the issuers have defaulted on interest payments. The Company does not intend to sell these securities prior to their recovery and it is more likely than not that it will not have to sell the securities prior to recovery. Management concluded that these securities were not other-than-temporarily impaired at December 31, 2019 and 2018. Future deterioration in the credit quality of these debt securities could result in impairment charges in the future.

4. Loans Receivable and Allowance for Loan Losses

The composition of loans receivable at December 31, 2019 and 2018 are as follows:

	2019	2018
	(In Thousands)	
Commercial	\$ 32,628	\$ 36,065
Commercial real estate	80,794	75,618
Residential mortgage	69,722	72,500
Home equity	17,501	16,836
Consumer, other	21,650	20,737
	<u>222,295</u>	<u>221,756</u>
Unearned net loan origination costs	393	321
Allowance for loan losses	<u>(2,650)</u>	<u>(2,258)</u>
	<u>(2,257)</u>	<u>(1,937)</u>
Net loans	<u>\$ 220,038</u>	<u>\$ 219,819</u>

The following tables summarize the activity in the allowance for loan losses by loan class for the years ended December 31, 2019 and 2018, and information in regard to the allowance for loan losses and the recorded investment in loans receivable by loan class as of December 31, 2019 and 2018:

December 31, 2019							
Allowance for Loan Losses							
Beginning Balance	Charge-offs	Recoveries	Provisions	Ending Balance	Ending Balance: Individually Evaluated for Impairment	Ending Balance: Collectively Evaluated for Impairment	
(In Thousands)							
Commercial	\$ 294	\$ -	\$ 109	\$ (115)	\$ 288	\$ 43	\$ 245
Commercial real estate	546	(2)	-	(21)	523	3	520
Residential mortgage	547	(33)	4	(72)	446	14	432
Home equity	107	-	-	(7)	100	-	100
Consumer, other	475	(949)	23	1,280	829	83	746
Unallocated	289	-	-	175	464	-	464
	<u>\$ 2,258</u>	<u>\$ (984)</u>	<u>\$ 136</u>	<u>\$ 1,240</u>	<u>\$ 2,650</u>	<u>\$ 143</u>	<u>\$ 2,507</u>

December 31, 2019			
Loans Receivable			
Ending Balance	Ending Balance: Individually Evaluated for Impairment	Ending Balance: Collectively Evaluated for Impairment	
(In Thousands)			
Commercial	\$ 32,628	\$ 96	\$ 32,532
Commercial real estate	80,794	3,323	77,471
Residential mortgage	69,722	1,034	68,688
Home equity	17,501	160	17,341
Consumer, other	21,650	91	21,559
	<u>\$ 222,295</u>	<u>\$ 4,704</u>	<u>\$ 217,591</u>

December 31, 2018							
Allowance for Loan Losses							
Beginning Balance	Charge-offs	Recoveries	Provisions	Ending Balance	Ending Balance: Individually Evaluated for Impairment	Ending Balance: Collectively Evaluated for Impairment	
(In Thousands)							
Commercial	\$ 340	\$ (124)	\$ -	\$ 78	\$ 294	\$ 10	\$ 284
Commercial real estate	821	-	-	(275)	546	-	546
Residential mortgage	579	(129)	-	97	547	17	530
Home equity	89	(34)	-	52	107	-	107
Consumer, other	45	(85)	21	494	475	94	381
Unallocated	392	-	-	(103)	289	-	289
	<u>\$ 2,266</u>	<u>\$ (372)</u>	<u>\$ 21</u>	<u>\$ 343</u>	<u>\$ 2,258</u>	<u>\$ 121</u>	<u>\$ 2,137</u>

December 31, 2018			
Loans Receivable			
Ending Balance	Ending Balance: Individually Evaluated for Impairment	Ending Balance: Collectively Evaluated for Impairment	
(In Thousands)			
Commercial	\$ 36,065	\$ 22	\$ 36,043
Commercial real estate	75,618	3,426	72,192
Residential mortgage	72,500	1,066	71,434
Home equity	16,836	25	16,811
Consumer, other	20,737	115	20,622
	<u>\$ 221,756</u>	<u>\$ 4,654</u>	<u>\$ 217,102</u>

The following tables present the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within the Company's internal risk rating system as of December 31, 2019 and 2018:

2019					
Pass	Special Mention	Substandard	Doubtful	Total	
(In Thousands)					
Commercial	\$ 31,624	\$ 908	\$ 96	\$ -	\$ 32,628
Commercial real estate	78,580	1,130	1,084	-	80,794
Residential mortgage	69,168	71	483	-	69,722
Home equity	17,339	2	160	-	17,501
Consumer, other	21,560	-	90	-	21,650
	<u>\$ 218,271</u>	<u>\$ 2,111</u>	<u>\$ 1,913</u>	<u>\$ -</u>	<u>\$ 222,295</u>

2018					
Pass	Special Mention	Substandard	Doubtful	Total	
(In Thousands)					
Commercial	\$ 35,991	\$ 15	\$ 59	\$ -	\$ 36,065
Commercial real estate	73,794	733	1,091	-	75,618
Residential mortgage	71,917	82	501	-	72,500
Home equity	16,805	6	25	-	16,836
Consumer, other	20,622	-	115	-	20,737
	<u>\$ 219,129</u>	<u>\$ 836</u>	<u>\$ 1,791</u>	<u>\$ -</u>	<u>\$ 221,756</u>

The following tables summarize information in regards to impaired loans by loan portfolio class as of December 31, 2019 and 2018:

2019					
	Recorded Investment (After Charge-offs)	Unpaid Principal Balance	Related Allowance (In Thousands)	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	\$ 15	\$ 15	\$ -	\$ 3	\$ 1
Commercial real estate	3,307	3,309	-	3,349	176
Residential mortgage	941	975	-	955	46
Home equity	160	160	-	89	15
Consumer, other	8	908	-	81	38
With an allowance recorded:					
Commercial	\$ 81	\$ 81	\$ 43	\$ 33	\$ 3
Commercial real estate	16	16	3	3	1
Residential mortgage	93	93	14	94	3
Home equity	-	-	-	-	-
Consumer, other	83	83	83	24	8
Total:					
Commercial	\$ 96	\$ 96	\$ 43	\$ 36	\$ 4
Commercial real estate	3,323	3,325	3	3,352	177
Residential mortgage	1,034	1,068	14	1,049	49
Home equity	160	160	-	89	15
Consumer, other	91	991	83	105	46
	<u>\$ 4,704</u>	<u>\$ 5,640</u>	<u>\$ 143</u>	<u>\$ 4,631</u>	<u>\$ 291</u>
2018					
	Recorded Investment (After Charge-offs)	Unpaid Principal Balance	Related Allowance (In Thousands)	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	\$ -	\$ 123	\$ -	\$ 27	\$ -
Commercial real estate	3,426	3,426	-	3,312	197
Residential mortgage	971	1,137	-	1,083	42
Home equity	25	59	-	27	2
Consumer, other	21	62	-	9	2
With an allowance recorded:					
Commercial	\$ 22	\$ 22	\$ 10	\$ 9	\$ 1
Commercial real estate	-	-	-	-	-
Residential mortgage	95	95	17	98	5
Home equity	-	-	-	-	-
Consumer, other	94	94	94	27	1
Total:					
Commercial	\$ 22	\$ 145	\$ 10	\$ 36	\$ 1
Commercial real estate	3,426	3,426	-	3,312	197
Residential mortgage	1,066	1,232	17	1,181	47
Home equity	25	59	-	27	2
Consumer, other	115	156	94	36	3
	<u>\$ 4,654</u>	<u>\$ 5,018</u>	<u>\$ 121</u>	<u>\$ 4,592</u>	<u>\$ 250</u>

The following table presents nonaccrual loans by classes of the loan portfolio as of December 31, 2019 and 2018.

	2019	2018
	(In Thousands)	
Commercial	\$ 36	\$ -
Commercial real estate	78	77
Residential mortgage	161	117
Home equity	144	16
Consumer, other	8	-
	<u>\$ 427</u>	<u>\$ 210</u>

The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. The following tables present the classes of the loan portfolio summarized by the past due status as of December 31, 2019 and 2018:

	2019							Loans Receivable >90 Days and Accruing
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Nonaccrual	Current	Total Loans Receivables	
	(In Thousands)							
Commercial	\$ -	\$ 111	\$ -	\$ 111	\$ 36	\$ 32,481	\$ 32,628	\$ -
Commercial real estate	484	-	-	484	78	80,232	80,794	-
Residential mortgage	573	-	-	573	161	68,988	69,722	-
Home equity	63	-	-	63	144	17,294	17,501	-
Consumer, other	96	143	65	304	8	21,338	21,650	65
	<u>\$ 1,216</u>	<u>\$ 254</u>	<u>\$ 65</u>	<u>\$ 1,535</u>	<u>\$ 427</u>	<u>\$ 220,333</u>	<u>\$ 222,295</u>	<u>\$ 65</u>

	2018							Loans Receivable >90 Days and Accruing
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Nonaccrual	Current	Total Loans Receivables	
	(In Thousands)							
Commercial	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 36,065	\$ 36,065	\$ -
Commercial real estate	257	-	-	257	77	75,284	75,618	-
Residential mortgage	84	150	2	236	117	72,147	72,500	2
Home equity	35	-	-	35	16	16,785	16,836	-
Consumer, other	20	14	83	117	-	20,620	20,737	83
	<u>\$ 396</u>	<u>\$ 164</u>	<u>\$ 85</u>	<u>\$ 645</u>	<u>\$ 210</u>	<u>\$ 220,901</u>	<u>\$ 221,756</u>	<u>\$ 85</u>

The Company may grant a concession or modification for economic or legal reasons related to a borrower's financial condition that it would not otherwise consider resulting in a modified loan which is then identified as a troubled debt restructuring (TDR). The Company may modify loans through rate reductions, extensions of maturity, interest only payments, or payment modifications to better match the timing of cash flows due under the modified terms with the cash flows from the borrowers' operations. Loan modifications are intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. TDRs are considered impaired loans for purposes of calculating the Company's allowance for loan losses.

The Company identifies loans for potential restructure primarily through direct communication with the borrower and evaluation of the borrower's consolidated financial statements, revenue projections, tax returns and credit reports. Even if the borrower is not presently in default, management will consider the likelihood that cash flow shortages, adverse economic conditions and negative trends may result in a payment default in the near future.

At December 31, 2019 and 2018, the Company has a recorded investment in TDRs of \$2,948,000 and \$3,033,000, respectively. The Company has allocated \$0 of specific allowance for these loans at December 31, 2019 and 2018, and has committed to lend no additional amounts on such loans.

The Company had no loan modifications made during the years ended December 31, 2019 and 2018 which were considered trouble debt restructurings.

The Company had no previously determined TDR loans that defaulted in 2019 or 2018.

5. Foreclosed Assets

Foreclosed asset activity was as follows for the years ended December 31, 2019 and 2018:

	2019	2018
	(In Thousands)	
Beginning balance	\$ 28	\$ 48
Loans transferred to foreclosed assets	50	137
Sales of foreclosed assets	(28)	(157)
	<u>\$ 50</u>	<u>\$ 28</u>

At December 31, 2019 and 2018, the recorded investment of residential mortgage and consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceeds are in process was \$0.

6. Bank Premises and Equipment

The components of bank premises and equipment at December 31, 2019 and 2018 are as follows:

	2019	2018
	(In Thousands)	
Land	\$ 1,100	\$ 1,100
Buildings and leasehold improvements	11,616	11,417
Furniture, fixtures and equipment	4,289	4,300
Right of use asset	726	-
Construction in progress	378	48
	<u>18,109</u>	<u>16,865</u>
Accumulated depreciation	(8,379)	(8,075)
	<u>\$ 9,730</u>	<u>\$ 8,790</u>

7. Deposits

The components of deposits at December 31, 2019 and 2018 are as follows:

	2019	2018
	(In Thousands)	
Demand, noninterest bearing	\$ 43,964	\$ 42,747
Demand, interest bearing	193,398	179,608
Savings	47,549	44,530
Time, \$250,000 and over	9,216	12,537
Time, other	67,582	50,156
	<u>\$ 361,709</u>	<u>\$ 329,578</u>

Included in time deposits, at December 31, 2019 and 2018, are brokered deposits of \$12,395,000 and \$2,956,000, respectively.

At December 31, 2019, the scheduled maturities of time deposits are as follows (in thousands):

2020	\$ 55,074
2021	15,260
2022	3,191
2023	1,187
2024	2,086
	<u>\$ 76,798</u>

8. Securities Sold Under Agreements to Repurchase

The Company enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. Under these arrangements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, these repurchase agreements are accounted for as collateralized financing arrangements (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability in the Company's consolidated balance sheets, while the securities underlying the repurchase agreements remain in the respective investment securities asset accounts. In other words, there is no offsetting or netting of the investment securities assets with the repurchase agreement liabilities. In addition, as the Company does not enter into reverse repurchase agreements, there is no such offsetting to be done with the repurchase agreements.

Securities sold under agreements to repurchase generally mature within a few days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. Securities sold under these agreements are retained under the Company's control at its safekeeping agent. The Company may be required to provide additional collateral based on the fair value of the underlying securities. Information concerning securities sold under agreements to repurchase for the years ended December 31, 2019 and 2018 is summarized as follows:

	2019	2018
	(Dollars In Thousands)	
Balance outstanding at December 31	\$ 3,173	\$ 3,440
Weighted average interest rate at the end of the year	0.77 %	0.71 %
Average daily balance during the year	\$ 2,937	\$ 3,865
Weighted-average interest rate during the year	0.78 %	0.45 %
Maximum month-end balance during the year	\$ 3,763	\$ 7,645

9. Other Borrowed Funds and Long-Term Debt

Other borrowed funds consist of short-term borrowings with the FHLB and with the U.S. Treasury. The Company has a \$60,000,000 line of credit arrangement with the FHLB. Short-term borrowings outstanding under this arrangement with the FHLB were \$17,642,000 and \$2,886,000 with a rate of 1.81 percent and 2.62 percent at December 31, 2019 and 2018, respectively.

Long-term debt of \$14,010,000 and \$64,460,000 at December 31, 2019 and 2018, respectively, consists of advances from the FHLB under various notes, with an average rate of 1.98 percent and 2.30 percent at December 31, 2019 and 2018, respectively. In 2019, the Company prepaid \$61,450,000 of these FHLB advances resulting in a prepayment penalty of \$738,000.

Maturities of long-term debt of \$14,010,000 at December 31, 2019 are due in 2020.

The Company has a maximum borrowing capacity with the FHLB of approximately \$154,000,000, of which \$31,652,000 was outstanding at December 31, 2019. Advances from the FHLB are secured by qualifying assets of the Bank.

As of December 31, 2019 and 2018, the Company had \$23,000,000 and \$25,000,000, respectively, available but undrawn in a letter of credit with the FHLB to secure municipal deposits held with the Bank.

10. Employee Benefit Plans

Employee Stock Ownership Plan (ESOP)

The Company has an Employee Stock Ownership Plan (ESOP) which is a noncontributory plan established to acquire shares of the Company's common stock for the benefit of all employees of the Company. Contributions to the plan are determined by the Board of Directors. Contributions charged to expense amounted to \$100,000 for the years ended December 31, 2019 and 2018. At December 31, 2019, 134,830 shares of the Company's common stock were held by the Employee Stock Ownership Plan Trust. In the event a terminated Plan participant desires to sell their shares of the stock, or for certain employees who elect to diversify their account balances, the Company may be required to purchase the shares from the participant at their fair market value.

401(k) Plan

The Company has a 401(k) Plan for eligible employees. The employees may contribute up to the maximum percentage of their compensation allowable by law to the Plan. The Company will make matching contributions up to 50 percent of the employee's contribution not to exceed 2 percent of eligible compensation. The Company will also make a safe-harbor contribution on the behalf of all participants in an amount equal to 3 percent of eligible compensation. The Company also may make discretionary contributions. Employees are immediately vested with respect to employee and Company contributions. The Company's contribution charged to expense was \$157,000 and \$154,000 for the years ended December 31, 2019 and 2018, respectively.

Executive Supplemental Income Plan

The Company has implemented a nonqualified Executive Supplemental Income (ESI) Plan for a certain group of officers. Under the provisions of the ESI Plan, the participating officers have executed agreements providing each officer a retirement annuity benefit, or their beneficiary a salary continuation benefit in the event of pre-retirement death. The Plan is informally funded by life insurance carried on the lives of these officers. The ESI benefit payable was \$189,000 and \$202,000 at December 31, 2019 and 2018, respectively, and is included in other liabilities in the accompanying consolidated balance sheets. For the years ended December 31, 2019 and 2018, \$8,000 and \$13,000, respectively, was charged to expense in connection with this Plan.

Deferred Compensation Plans

The Company has established several deferred compensation plans for participating Directors. Under these plans, the Company will make deferred income payments for a ten-year period generally beginning at age 65, or at death if earlier.

To informally fund benefits under the Plan, the Company is the owner and beneficiary of life insurance policies on the lives of the participating directors. Deferred compensation payable at December 31, 2019 and 2018 was \$522,000 and \$504,000, respectively, and is included in other liabilities in the accompanying consolidated balance sheets. For the years ended December 31, 2019 and 2018, \$46,000 and \$47,000, respectively, was charged to expense in connection with these plans.

11. Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities and changes in the defined benefit pension plan, are reported as a separate component of the equity section of the consolidated balance sheets, net of related income taxes, such items, along with net income, are components of accumulated comprehensive loss.

The components of accumulated other comprehensive loss and the related income tax effect are as follows as of December 31, 2019 and 2018:

	2019	2018
	(In Thousands)	
Unrealized holding losses on available-for-sale securities	\$ (756)	\$ (5,337)
Tax effect	159	1,115
Net of income taxes	(597)	(4,222)
Derivative adjustments	(17)	-
Tax effect	4	-
Net of income taxes	(13)	-
Accumulated other comprehensive loss	<u>\$ (610)</u>	<u>\$ (4,222)</u>

12. Federal Income Taxes

The components of income tax expense for the years ended December 31, 2019 and 2018 are as follows:

	2019	2018
	(In Thousands)	
Current	\$ 416	\$ 618
Deferred	44	(101)
	<u>\$ 460</u>	<u>\$ 517</u>

A reconciliation of the statutory income tax at a rate of 21 percent to the income tax expense included in the statements of income is as follows for the years ended December 31, 2019 and 2018:

	2019		2018	
	Amount	Percent of Pre-Tax Income	Amount	Percent of Pre-Tax Income
	(Dollars in Thousands)			
Federal income tax at statutory rate	\$ 602	21 %	\$ 702	21 %
Tax exempt interest	(102)	(6)	(121)	(6)
Bank-owned life insurance	(45)	(3)	(46)	(2)
Other	5	-	(18)	(1)
	<u>\$ 460</u>	<u>12 %</u>	<u>\$ 517</u>	<u>12 %</u>

Net deferred tax assets and liabilities (which are included in prepaid expenses and other assets) consisted of the following components as of December 31, 2019 and 2018:

	2019	2018
	(In Thousands)	
Deferred tax assets:		
Allowance for loan losses	\$ 430	\$ 356
Deferred compensation	149	148
Net unrealized losses on securities available-for-sale	159	1,111
Net unrealized loss on derivatives	4	-
Right of use asset	153	-
Nonaccrual loan interest	4	4
Accrued expenses	2	-
	<u>901</u>	<u>1,619</u>
Deferred tax liabilities:		
Bank premises and equipment	250	237
Discount accretion	7	14
Prepaid expenses	83	69
Lease liability	152	-
Loan origination costs	109	95
Other	25	-
	<u>626</u>	<u>415</u>
Net deferred tax asset	<u>\$ 275</u>	<u>\$ 1,204</u>

The Company follows accounting guidance related to the accounting for uncertainty in income taxes, which sets out a consistent framework to determine the appropriate level of tax liabilities to maintain for uncertain tax positions. The Company had no material unrecognized tax benefits or accrued interest and penalties as of December 31, 2019 and 2018. The Company's policy is to account for interest as a component of interest expense and penalties as a component of other expense.

13. Transactions With Executive Officers, Directors and Principal Stockholders

The Company has had, and may be expected to have in the future, banking transactions in the ordinary course of business with its executive officers, directors, principal stockholders, their immediate families and affiliated companies (commonly referred to as related parties), on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. These persons were indebted to the Company for loans totaling \$444,000 and \$551,000 at December 31, 2019 and 2018, respectively. During 2019, \$50,000 of new loans and \$157,000 of repayments were made. These persons had deposits with the Company totaling \$4,181,000 and \$3,562,000 at December 31, 2019 and 2018, respectively.

14. Right of Use Asset and Lease Liabilities

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, which superseded the lease requirements in Topic 840. The ASU required lessees to recognize a right of use asset and related lease liability for all leases, with a limited exception for short-term leases. Leases are classified as either finance or operating, with the classification affecting the pattern of expense recognition in the consolidated statements of income. Previously, leases were classified as either capital or operating, with only capital leases recognized on the consolidated balance sheets. The reporting of lease related expenses in the consolidated statements of income and cash flows are generally consistent with the current guidance.

The Company's three leases are all classified as operating leases with no short-term leases. Currently, all of the leases are for branch leases and two out of three contain renewal options. The recorded amounts for the branch leases are impacted by assumptions around renewals and/or extensions and the interest rate used to discount those future lease obligations. In accordance with the guidance, the Company had an increase on its consolidated balance sheet as of December 31, 2019 for the right of use asset of \$726,000 recorded in bank premises and equipment, offset by lease liabilities of \$726,000 recorded in other liabilities on the consolidated balance sheets. Operating cash flow paid for lease liabilities was \$122,000. As of December 31, 2019, the operating leases overall had a weighted average lease term of 7.08 years. The weighted average discount rate for the operating leases was 2.50 percent.

A reconciliation of operating lease liabilities by minimum lease payments by year and in aggregate and discount amounts in aggregate, as of December 31, 2019, are as follows (in thousands):

2020	\$	128
2021		112
2022		113
2023		114
2024		93
Thereafter		237
Total undiscounted lease liabilities		797
Less discounted amount		69
Total lease liabilities	\$	728

15. Derivative Financial Instruments

The Company is exposed to certain risk arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity and credit risk primarily by managing the amount, sources and duration of its assets and liabilities and the use of derivative financial instruments. Specifically, the Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company's derivative financial instruments are used to manage differences in the amount, timing and duration of the Company's known or expected cash receipts and its known or expected cash payments principally related to the Company's borrowings.

The Company's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate caps as part of its interest rate risk management strategy. Interest rate caps designated as cash flow hedges involve the receipt of variable amounts from a counterparty if interest rates rise above the strike rate on the contract in exchange for an up-front premium.

For derivatives designated and that qualify as cash flow hedges of interest rate risk, the gain or loss on the derivative is recorded in accumulated other comprehensive loss and subsequently reclassified into interest expense in the same period(s) during which the hedged transaction affects earnings. Gains and losses on the derivative representing hedge components excluded from the assessment of effectiveness are over the life of the hedge on a systematic and rational basis, as documented at hedge inception in accordance with the Company's accounting policy election. The earnings recognition of excluded components is presented in interest expense. Amounts reported in accumulated other comprehensive loss related to derivatives will be reclassified to interest expense as interest payments are made on the Company's variable-rate debt. During 2020, the Company estimates that an additional \$23,000 will be reclassified as an increase to interest expense.

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the consolidated balance sheets as of December 31, 2019:

2019 (in thousands)				
	Asset Derivatives		Liability Derivatives	
	Notional Amount	Fair Value (1)	Notional Amount	Fair Value
Interest rate products	\$ 50,000	\$ 94	\$ -	\$ -
Total derivatives	\$ 50,000	\$ 94	\$ -	\$ -

(1) Included in other assets in the consolidated balance sheets.

The table below presents the effect of cash flow hedge accounting on accumulated other comprehensive income as of December 31, 2019:

	Amount of Loss Recognized in OCI (in thousands)		
	On Derivative	Included Component	Excluded Component
Derivatives in cash flow:			
Hedging relationships			
Interest rate products	\$ (26)	\$ -	\$ (26)
Total	\$ (26)	\$ -	\$ (26)

	Amount of Loss Reclassified From Accumulated OCI (in thousands)		
	Into Income (2)	Into Income Included Component	Into Income Excluded Component
Derivatives in cash flow:			
Hedging Relationships			
Interest rate products	\$ (9)	\$ -	\$ (9)
Total	\$ (9)	\$ -	\$ (9)

(2) Included in interest expense in the consolidated statements of income

As of December 31, 2019, the fair value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was \$0.

16. Financial Instruments With Off-Balance Sheet Risk

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

A summary of the Company's financial instrument commitments at December 31, 2019 and 2018 is as follows:

	2019	2018
	(In Thousands)	
Commitments to grant loans	\$ 9,773	\$ 9,672
Unfunded commitments under lines of credit	20,692	23,913
Outstanding letters of credit	1,138	947

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include personal or commercial real estate, accounts receivable, inventory and equipment.

Outstanding letters of credit written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The majority of these standby letters of credit expire within the next twelve months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Company requires collateral supporting these letters of credit as deemed necessary. The maximum undiscounted exposure related to these commitments at December 31, 2019 and 2018 was \$1,138,000 and \$947,000, respectively, and the approximate value of underlying collateral upon liquidation that would be expected to cover this maximum potential exposure was \$1,138,000 and \$947,000, respectively. The current amount of the liability as of December 31, 2019 and 2018 for guarantees under standby letters of credit issued is not material.

17. Regulatory Matters

The Company is required to maintain a cash reserve balance in vault cash or with the Federal Reserve Bank. The total of this reserve balance was approximately \$108,000 and \$51,000 at December 31, 2019 and 2018, respectively.

The Company and its Bank subsidiary are subject to various regulatory capital requirements administered by the federal banking agencies. The final rules implementing BASEL Committee on Banking Supervisor's Capital Guidance for U.S. banks (BASEL III rules) became effective for the Company on January 1, 2015, with full compliance with all of the requirements being phased in over a multi-year schedule and fully phased in by January 1, 2019. Under the BASEL III rules, the Company and Bank must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0 percent for 2015 to 2.50 percent by 2019. The capital conservation buffer for 2019 is 2.50 percent. The net unrealized gain or losses on available-for-sale securities is not included in computing regulatory capital amounts. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and its Bank subsidiary must meet specific capital guidelines that involve quantitative measures of its assets, liabilities and certain off-balance sheet items calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk-weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the maintenance of minimum amounts and ratios (set forth on the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets, Tier 1 capital to average assets and common equity Tier 1 capital to risk-weighted assets. Management believes, as of December 31, 2019, that the Company and its Bank subsidiary meet all capital adequacy requirements to which they are subject.

As of December 31, 2019, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, common equity risk based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since that notification that management believes have changed the Bank's category. The Company's ratios do not differ significantly from the Bank's ratios presented below. The Bank's actual capital amounts and ratios are as follows at December 31, 2019 and 2018:

	2019					
	Actual		For Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollar Amounts in Thousands)					
Total capital (to risk-weighted assets)	\$ 43,722	15.41 %	\$ >22,731	> 8.00 %	\$ >28,413	> 10.00 %
Common equity Tier 1 (CET1) capital (to risk-weighted assets)	41,122	14.47	>12,786	> 4.50	>18,469	> 6.50
Tier 1 (core) capital (to risk-weighted assets)	41,122	14.47	>17,048	> 6.00	>22,731	> 8.00
Tier 1 (core) capital (to average assets)	41,122	9.11	>18,055	> 4.00	>22,569	> 5.00

	2018					
	Actual		For Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollar Amounts in Thousands)			
Total capital						
(to risk-weighted assets)	\$ 42,131	14.51 %	\$ >23,277	>8.00 %	\$ >29,034	10.00 %
Common equity Tier 1 (CET1) capital						
(to risk-weighted assets)	39,873	13.73	>13,065	> 4.50	>18,872	> 6.50
Tier 1 (core) capital						
(to risk-weighted assets)	39,873	13.73	>17,420	> 6.00	>23,227	> 8.00
Tier 1 (core) capital						
(to average assets)	39,873	8.88	>17,959	> 4.00	>22,449	> 5.00

The Bank is subject to certain restrictions on the amount of dividends that it may declare without prior regulatory approval.

18. Fair Value Measurements and Fair Value of Financial Instruments

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The fair value of financial instruments is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices in active markets. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instruments.

Fair value accounting guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

In accordance with this guidance, the Company groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 - Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 - Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3 - Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2019 and 2018 are as follows:

2019				
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(In Thousands)			
State and political subdivisions	\$ 48,175	\$ -	\$ 48,175	\$ -
Mortgage-backed securities, GSE's, residential	107,098	-	107,098	-
Corporate debt securities	34,047	-	34,047	-
Equity securities	153	-	153	-
Derivatives	94	-	94	-
	<u>\$ 189,567</u>	<u>\$ -</u>	<u>\$ 189,567</u>	<u>\$ -</u>
2018				
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(In Thousands)			
State and political subdivisions	\$ 15,469	\$ -	\$ 15,469	\$ -
Mortgage-backed securities, GSE's, residential	128,919	-	128,919	-
Corporate debt securities	43,683	-	43,683	-
Equity securities	223	-	223	-
	<u>\$ 188,294</u>	<u>\$ -</u>	<u>\$ 188,294</u>	<u>\$ -</u>

For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2019 and 2018 are as follows:

2019				
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(In Thousands)		
Impaired loans	\$ 94	\$ -	\$ -	\$ 94
Foreclosed assets	\$ 50	\$ -	\$ -	\$ 50
2018				
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(In Thousands)		
Impaired loans	\$ 90	\$ -	\$ -	\$ 90
Foreclosed assets	\$ 28	\$ -	\$ -	\$ 28

Quantitative information about Level 3 fair value measurements at December 31, 2019 and 2018 is included in the table below:

2019				
Quantitative Information About Level 3 Fair Value Measurements				
	Fair Value Estimate	Valuation Techniques	Unobservable Inputs	Estimated Range
		(In Thousands)		
Impaired loans	\$ 94	Appraisal of collateral	Appraisal adjustments	0%-65%
			Liquidation expenses	7%
Foreclosed assets	\$ 50	Appraisal of collateral	Appraisal adjustments	0%-25%
			Liquidation expenses	7%

2018				
Quantitative Information About Level 3 Fair Value Measurements				
	Fair Value Estimate	Valuation Techniques	Unobservable Inputs	Estimated Range
		(In Thousands)		
Impaired loans	\$ 90	Appraisal of collateral	Appraisal adjustments	0%-65%
			Liquidation expenses	7%
Foreclosed assets	\$ 28	Appraisal of collateral	Appraisal adjustments	0%-25%
			Liquidation expenses	7%

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Company's financial instruments at December 31, 2019 and 2018:

Cash and Cash Equivalents (Carried at Cost)

The carrying amounts reported in the balance sheet for cash and short-term instruments approximate those assets' fair values.

Securities

The fair value of securities (carried at fair value) are determined by quoted prices in an inactive market or matrix pricing (Level 2). Matrix pricing is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices.

Loans Receivable (Carried at Cost)

The fair values of loans, including loans held for sale, are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

Impaired Loans (Generally Carried at Fair Value)

Impaired loans carried at fair value are those in which the Company has measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. The fair value at December 31, 2019 consists of loan balances of \$237,000, less a valuation allowance of \$143,000. The fair value at December 31, 2018 consists of loan balances of \$211,000, less a valuation allowance of \$121,000.

Servicing Rights (Carried at Lower of Cost or Fair Value)

The fair value of mortgage servicing right is based on a valuation model that calculates the present value of estimated net servicing income. The valuation incorporation assumptions that market participants would use in estimating future net servicing income.

Restricted Investment in Bank Stocks (Carried at Cost)

The carrying amount of restricted investment in bank stocks approximates fair value and considers the limited marketability of such securities.

Accrued Interest Receivable and Payable (Carried at Cost)

The carrying amount of accrued interest receivable and accrued interest payable approximates its fair value.

Derivatives (Carried at Fair Value)

Derivative instruments are valued using market interest rates and market volatility as inputs to a modified Black-Scholes model.

Deposit Liabilities (Carried at Cost)

The fair values disclosed for demand deposits (e.g., interest and noninterest checking, passbook savings and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Other Borrowed Funds (Carried at Cost)

The carrying amounts of other borrowed funds approximate their fair values.

Long-Term Debt (Carried at Cost)

Fair values of FHLB advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB advances with similar credit risk characteristics, terms and remaining maturity. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

Off-Balance Sheet Financial Instruments

Fair values for the Company's off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account, the remaining terms of the agreements and the counterparties' credit standing. The fair value of these off-balance sheet financial instruments was not material at December 31, 2019 and 2018.

The estimated fair value of the Company's financial instruments at December 31, 2019 and 2018 were as follows:

2019					
	Carrying Value	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
			(In Thousands)		
Financial assets:					
Cash and cash equivalents	\$ 6,120	\$ 6,120	\$ 6,120	\$ -	\$ -
Securities available-for-sale	189,473	189,473	-	189,473	-
Restricted investment in bank stocks	1,967	1,967	-	1,967	-
Loans receivable, net	220,038	222,194	-	-	222,194
Accrued interest receivable	1,122	1,122	-	1,122	-
Derivatives	94	94	-	94	-
Financial liabilities:					
Deposits	\$ 361,709	\$ 345,997	\$ -	\$ -	\$ 345,997
Other borrowed funds	17,642	17,642	-	17,642	-
Accrued interest payable	94	94	-	94	-
Long-term debt	14,010	14,092	-	14,092	-
2018					
	Carrying Value	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
			(In Thousands)		
Financial assets:					
Cash and cash equivalents	\$ 5,152	\$ 5,152	\$ 5,152	\$ -	\$ -
Securities available-for-sale	188,294	188,294	-	188,294	-
Restricted investment in bank stocks	3,286	3,286	-	3,286	-
Loans receivable, net	219,819	219,799	-	-	219,799
Accrued interest receivable	1,226	1,226	-	1,226	-
Financial liabilities:					
Deposits	\$ 329,578	\$ 296,198	\$ -	\$ -	\$ 296,198
Other borrowed funds	2,886	2,886	-	2,886	-
Accrued interest payable	168	168	-	168	-
Long-term debt	64,460	63,762	-	63,762	-

Directors of Mauch Chunk Trust Financial Corp.

Charles E. Wildoner, Chairman of Board
Patrick H. Reilly, President/Chief Executive Officer
William R. Reabold, Secretary
Dr. Edward C. Beckett III
Thomas R. Lisella
James R. Nanovic
Ida M. Queen
James E. Smith, Jr. (Deceased, January 2020)

Other Officers

Denise M. Rautzhan, Treasurer
Joanne Uhrie, Assistant Secretary

Director Emeritus

Edward J. McElmoyle

Jim Thorpe Advisory Board

Mary E. Enck
Sky Fogal
Shawn M. Kresge
Kevin J. McArdle*
Sheila L. O'Neil

Solicitor

Nanovic Law Offices

Lehighon Advisory Board

Dean R. Arner
Jay C. Frey
Richard L. Getz, Jr.
Jeff A. Hill*
Dr. William A. Howland
William G. Schwab
Dr. Daniel W. Steigerwalt
Christopher L. Wentz

Tamaqua Advisory Board

James C. Agosti
Jeffrey P. Bowe
Ettore DiCasimirro
Matthew J. Hope
Joseph A. Mehalko
Lucy M. Murphy
John M. Nonnemacher
Charles C. Snyder
Tammy Sword
Jon M. Zizelmann*

**Advisory Board Chairman*

**Main Office**

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Branch Offices**Lehighon**

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Lehighon, PA 18235

Jim Thorpe

Railroad Station- 1 Susquehanna Street
Jim Thorpe, PA 18229

Pine Point

Pine Point Plaza- 7 Pine Point Drive
Albrightsville, PA 18210

Redner's Warehouse Market

184 Market Street
Nesquehoning, PA 18240

Hometown

226 Claremont Avenue
Tamaqua, PA 18252

West Penn

1331 Clamtown Road
Tamaqua, PA 18252

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